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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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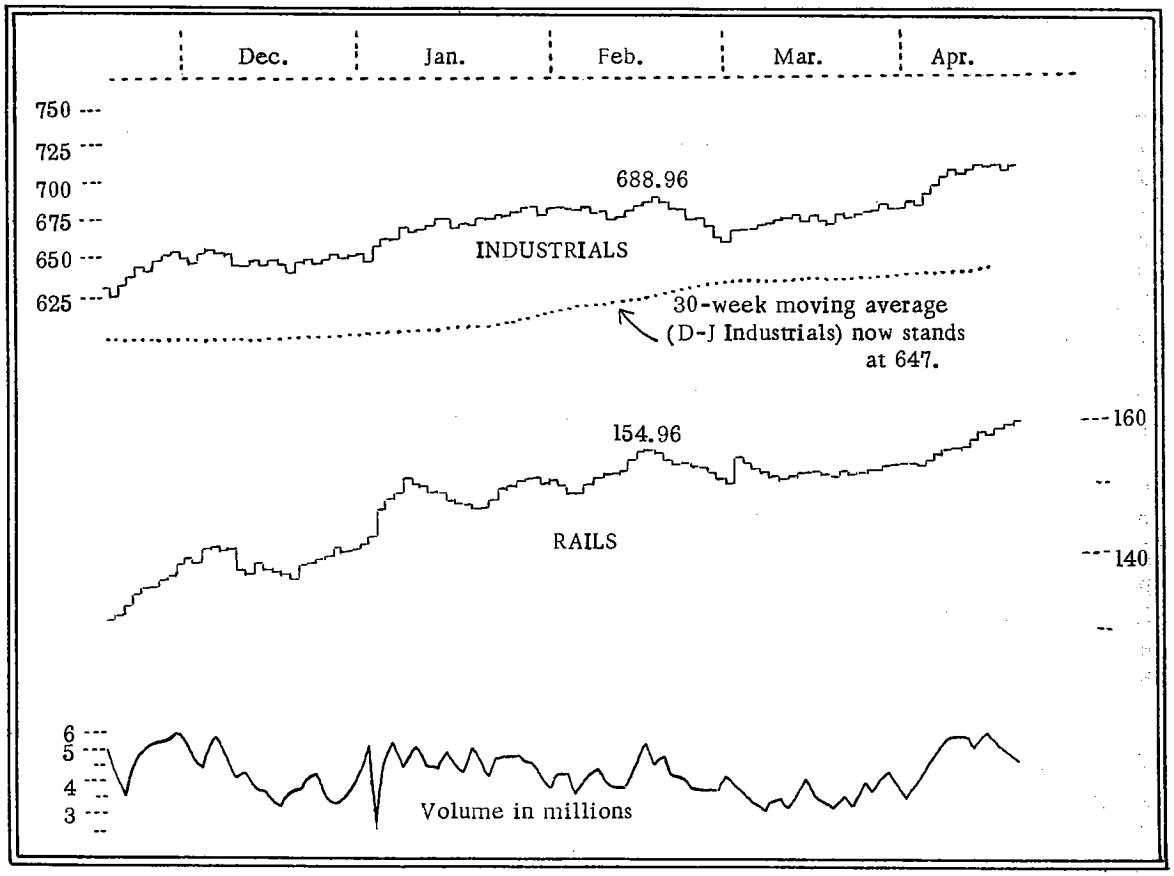
THE MARKET Less than a year ago anguished analysts were assessing the reasons for the 1962 collapse, and the consensus was that stocks at the 1961-62 highs had been "out of touch with economic realities". Those who refused to view the 1962 debacle as a forecast of things to come in the economy were quick to suggest that the decline represented "a much-needed major correction of market excesses". As this is written, the Industrial Average is within 25 points of its 1961 high, Rails are above their 1961 high -- but little is now said about stocks being "overvalued". Moreover, most of the professional element is now talking about "new highs" as if such highs were a foregone conclusion--while the public (as judged by odd-lot activities) could not care less what the professionals think, or for that matter, whether the market rallies to new highs or drops to new lows.

What does it add up to? My own feeling is that this is a time to rid oneself of all preconceived notions. "The market can do anything", runs the old adage, and the truth of this observation may easily be proved over the period ahead.

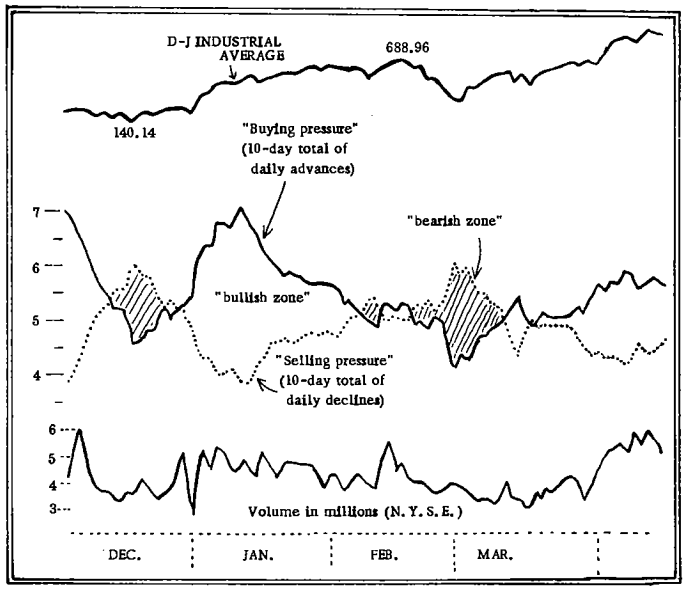
As seen on the chart, volume over the past 11 days has been running high (a total of 58 million shares since April 4-- or about 5.3 million shares per day) During this time the Industrial Average has gained 11 points or roughly 1 point for every 5 million shares of turnover. This is a lot of "steam under the boiler" for so little progress, and I consider it to be "churning" action. Nevertheless, with the Industrial Average so close to its all-time high, the market is undoubtedly running into a huge supply of stock. Many amatuer speculators purchased shares at and around the 1961-62 highs. If the current churning action represents the absorption of this (weak) stock by strong ("smart") money, then new highs for the Averages are assured. On the other hand, if informed traders and investors are now swapping stock certificates for cash under the guise of the current high-volume, excited activity, we will shortly witness a market in trouble.

One important hint: if stocks move up on heavy volume, then settle back grudgingly on reduced volume, the implications are bullish. But if heavy volume puts stocks up and they then lose most or all of their gains on a light volume decline, the situation is bearish and is indicative of distribution. A second hint: in a strong market a "line" or sideways movement can take the place of a normal correction. Following a high volume advance, if the Averages move sideways as volume diminishes, the implications are bullish. Currently, the market should be watched for the appearance of either



 of the aforementioned phenomena.

BUYING AND SELLING PRESSURE The buying pressure line (see chart) has held above the selling line since March 12 or for 27 consecutive days. The two lines moved farthest apart on April 8. Since then (amid heavy volume) they have moved slightly together. This suggests some distribution amid "churning" volume.

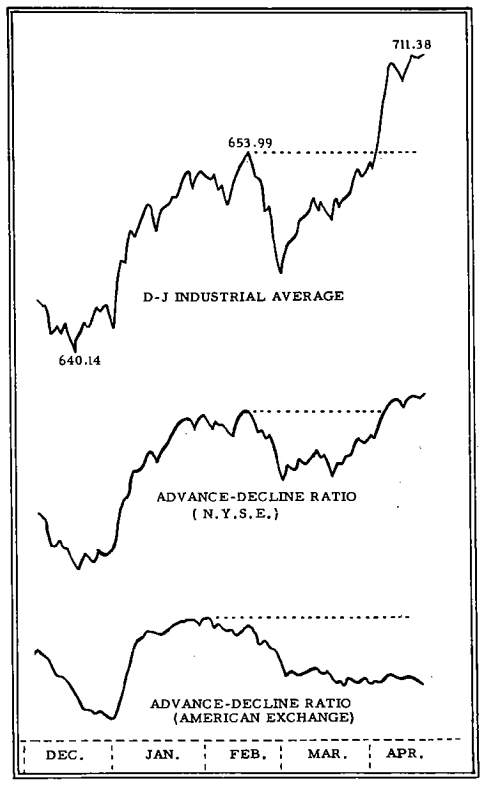


Normally, the two lines cross and recross every 15 to 30 days (see Letter 210). But occasionally one of the lines holds above the other for an extremely long period of time. When this occurs, it is a sign that a major movement is underway (for instance, during the "power rise" of 1960-61 the buying line held above the selling line for 82 days). Therefore, if the buying line holds above selling for another week or so, we will be alerted to the possibility of a major extension of the current advance. Conversely, if the recent tendency of the two lines to approach each other result in an actual crossing (with selling above buying), we will have an early warning of potential trouble ahead (particularly if volume remains high following a bearish crossing).

"BLUE-CHIPS" FOREVER? The high quality stocks continue to give an excellent account of themselves while the rest of the issues on both Exchanges turn in a mixed performance. For instance, during the two weeks ending April 12 the D-J Industrial Average rallied 26 points while Barron's Low-Priced Stock Index held practically unchanged (actually up 1 point). During the last two months the trend of the majority of issues on the N.Y.S.E. was up, and this served to push the advance-decline ratio (see chart) to a new recovery high. But the more speculative American Exchange (as represented by the A-D ratio on that Exchange -- see chart) simply worked sideways. In other words, there has been no real upward movement in the majority of stocks on the "Junior Exchange".

Personally, I do not ever remember seeing a move carry this long or this far in the D-J Averages without it somehow "rubbing off" on the rest of the list. Moreover, I find myself wondering how much longer this set of peculiar circumstances can go on (i.e., the upward push of the Averages against a background of public apathy and actual listlessness in the secondary, speculative and low-priced issues). The situation is all the more extraordinary in view of the fact that daily volume on the N.Y.S.E. has expanded impressively over the past few weeks (as the Averages rose out of their "line" area). Volume in the 5-6 million share class is usually accompanied by at least a dash of speculative fireworks. Not so -- on the move so far.

If there is a hint of a forthcoming profitable move in the "cats-and-dogs", it may be showing itself in that former "home of market pyrotechnics", Toronto. The great Canadian boom in mining stocks occurred in the mid-1950's, when, in a single year (1955), the value of all Toronto Exchange stocks actually doubled. That same year Toronto mining issues raised a record 102 million dollars in new capital. In 1957 the Canadian boom collapsed; it has remained dead ever since. Recently, however, a stream of new money and new issues has struck Toronto again, and activity there has perked up in the most sustained spate since 1955. This could be a preview of "things to come" in Toronto and perhaps in this country. It will bear the closest watching.



Readers may wonder why I have dwelled so extensively upon the speculative low-priced stocks. This writer, for instance, did better with low-priced stocks in the space of a single year -- 1958-59 -- than he did in the previous four years with high-grade issues. Should the public enter the market en masse during the coming months, it seems to me that they will (almost by necessity) move into the low-priced issues. With the D-J Industrial Average now yielding 3.29%, it will be difficult for people to convince themselves that they should buy blue-chip stocks for income and investment purposes. In other words, if the public comes into the market, it will enter with speculation (not income and values) in mind. The D-J stocks are now high-priced -- therefore, it will be the cyclical issues, the secondary issues and the "cats-and-dogs" which will receive the "play".

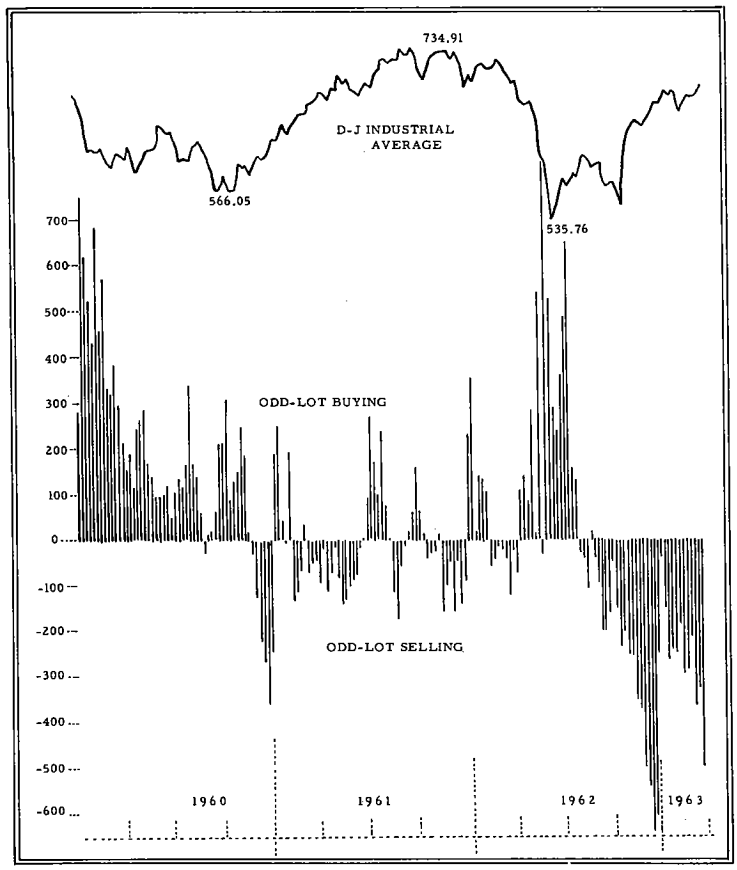
The question remains -- from the standpoint of profitable speculation, should one purchase low-priced stocks here with the idea of waiting for the entrance of the public? Or should one wait for actual signs of interest in the speculative sector of the market before buying those issues?

My own inclination is to take limited speculative positions in some of the stronger low-priced stocks at this time. These include Spiegel (see Letter 206), Allis-Chalmers (see Letter 207), Alco Products, Cudahy Packing (see Letter 215), Kaiser Industries (American Exchange), and lastly Tri-Continental Warrants (Letter 214) for general leverage.

MORE ABOUT THE PUBLIC The accompanying chart shows the official S.E.C. record of odd-lot purchases over sales (figures above 0), and odd-lot sales over purchases (figures below 0) for the period since January, 1960. These statistics are weekly balances, and they appear each Tuesday in the Wall Street Journal (and Monday in Barron's).

On the chart we see the initial heavy "buying response" of the odd-lotters during early 1960 -- following the announcement of the steel strike settlement. But as the market declined, the enthusiasm of the odd-lotter also waned, and near the "bottom" in late 1960 the odd-lot balances finally switched to the selling side.

The climb from October, 1960, to December, 1961, was accompanied by a preponderance of selling balances. Throughout that period nothing approaching the buying enthusiasm of early 1960 occurred. This lack of public optimism served to fortify the bullishness of many analysts. During early 1962, however, the market turned sharply lower. To everyone's astonishment, the collapsing price structure then produced some of the heaviest odd-lot balances in history ("lower prices must be bargains"). The end result was the worst "crash" since 1937.



The Industrial Average struck bottom in June, 1962, but the majority of stocks recorded their lows four months later, in October. Between June and October the odd-lot public became increasingly sceptical. In fact, towards the end of 1962 the odd-lotters sold at the heaviest rate ever recorded by these studies. Although this rate of selling has since been reduced, as seen on the chart the odd-lot public is still strongly on the selling side of the ledger.

What is the significance of the 1962-63 area of odd-lot selling? The obvious interpretation is that the odd-lot public has been "handing in its stock" as the market rose, and thus equities have been passing steadily from weak hands to strong hands. The disillusionment of the public is further born out in the statistics on mutual fund purchases and redemptions and the latest monthly figures show that the net surplus of purchases over sales is quite small (50 million dollars). Mutual fund investors are therefore showing the same sort of scepticism as are the odd-lotters.

I see little sense in going against the classical interpretation of current and recent odd-lot action. Nevertheless, I am somewhat wary of the very broad publicity now being given to the odd-lot statistics. When technical indicators are too widely followed, they often prove to be tricky. My own guess is that the "tricky" aspect of the odd-lots could show itself as follows: in 1961 the market turned down amid odd-lot selling, but the actual weakness showed when odd-lotters switched to buying as the market continued its decline. I feel that events at the final top of the current move could be just as fast and deceptive -- perhaps a week or so of odd-lot buying, and then heavier buying as the market turns down. Or perhaps the market will turn amid odd-lot selling, and the weakness again will only show as the decline progresses and the odd-lotters switch to the "buy side" of the market.

PERSONAL VIEWS The question most often received here: "Why the sustained advance -- what is the market saying?" With the Industrial Average now yielding less the 3.3%, the market has undoubtedly discounted much of the potential of a broad expansion in corporate earnings. Many intelligent men also believe that stocks are now discounting the possibility of planned "fiscal arson". Thus, George Shea (Wall Street Journal, April 15) writes: "We have a national Administration which is

committed to the proposition that today's deficit produces tomorrow's surplus. We are headed, in the current fiscal year to June 30, for the second biggest peacetime Federal deficit in history... On top of this the Administration advocates extensive tax cuts in the face of further increases in Federal expenditures."

Personally, I am convinced that it was this same inflationary policy (in the U. S. and England) which caused De Gaulle (with the tacit consent of Adenauer) to bar Britain from the Common Market. The French leader does not want "funny money" advocates weakening the fiscal framework of Western Europe (both France and Germany have had disastrous experiences with rampant inflation.)

Furthermore, a new and important event may currently be taking place in U. S. - Foreign relations. The U. S. Treasury has been "buying time" (against the adverse balance-of-payments situation) by borrowing hard money from foreign nations. This money can be used as a stop-gap against a potential raid on the dollar. But according to economist Eliot Janeway's report, the current rumor is that France has rejected a U. S. application for a $100 million loan. If true, it puts the U. S. in a strange and embarrassing situation -- the strongest financial power in Europe has now refused to lend us money.

STOCKS Of 350 stocks which are tabulated each week at this office, 281 (80%) are holding above their 30-week moving average, an improvement of 12% over last week.

In Letter 213 I mentioned that friends in New York were accumulating GM, and that they considered it one of the few "underpriced" blue-chips on the board. Along these lines, the accompanying "clip" from the April 13 issue of Business Week should prove interesting to readers. Callers from Wall Street continually ask one question: "Will the market boil? Will the low-priced speculative issues 'take off'?" My answer is that Industrials are now within 5% of their 1961 high and the "crowd" stocks have not yet moved. I am convinced that it will take a new all-time high (above 734.91) to bring the public back into the market. Conversely, if Industrials refuse to better the 734.91 high, I do not believe we will see a speculative market.

BUSINESS WEEK April 13, 1963

Seth Glickenhaus, whose $8-million killing in American Telephone & Telegraph debentures still ranks as one of Wall Street's great coups [BW Jun.20'59,p175], is off on a new play. This time, it's simply taking a position in another blue chip—General Motors. Glickenhaus has 100,000 shares of GM—and his paper profits are over $1-million.

I include two charts (daily) of medium-priced issues, Spiegel and Allis-Chalmers. Each of these stocks has recently moved above its peaks of last July-August, and each has done so on a noticeable increase in volume. I feel that these two issues could do well IF the market broadens out into secondary issues. Note that Allis-Chalmers has now "pulled back" to approximately the break-out point of 17 1/2. Spiegel has also pulled back to its break-out point of 29. If the stocks are essentially strong, they should hold above the break-out levels, and those levels should now be "resistance", the theory being that all the available stocks below the break-out points has now been absorbed.

Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri